

11 U.S.C. § 506(a)
valuation
11 U.S.C. § 1325(a)(3)
good faith

In re McElroy, Case No. 397-30230-elpl3

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ELP

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The value of debtors' two vehicles, which they planned to retain, was the fair market value, not the replacement value. See In re Rash, 1997 WL 321231 (June 16, 1997). Fair market value is the cash price a willing buyer would pay a willing seller in an arms-length transaction. The court determined the value of the vehicles based on prices paid in the market that is accessible to debtors, which includes, without limitation, sales by dealers to the public, auctions open to the public, and sales between private parties. From prices realized at such sales, the court deducted value added by reconditioning, warranties and the costs of other services or additions provided by the seller. The court also recognized that it might need to adjust the price to eliminate the effect of extra cost and profit items, such as whether there was a trade-in, financing, or mechanical warranties.

The court held that debtors proposed their plan in good faith. Although this was their second Chapter 13 filing within a short period, their circumstances had changed in that their first case was dismissed for failure to make a plan payment because they had to pay an unanticipated utility deposit, and they have had an increase in income. They have not manipulated the bankruptcy process or gained anything by the successive filings.

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UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF OREGON

In Re:) Bankruptcy Case No.
) 397-30230-elp13
STEPHEN DUANE McELROY,)
DIXIE KAY McELROY,) MEMORANDUM OPINION
)
Debtors.)

Ford Motor Credit Company ("FMCC") objects to confirmation of the Chapter 13 plan proposed by Stephen and Dixie McElroy on the basis that the McElroys' value of their two vehicles is too low, the plan is not feasible and it does not meet the good faith requirement.

FACTS

The McElroys filed Chapter 13 on September 23, 1996. The court dismissed the 1996 case on January 9, 1997 because debtors missed a plan payment. Mr. McElroy testified that they missed the plan payment because they had to pay unanticipated utility deposits. On January 13, 1997 the McElroys filed this Chapter 13 case.

ISSUES

1. What is the value of debtors' two vehicles?
2. Does debtors' filing of two Chapter 13 cases within a short time period preclude a finding that they proposed their plan in good faith?

1 3. Is debtors' plan feasible?

2 DISCUSSION

3 I. VALUATION

4 The McElroys own two vehicles, a 1987 Ford F-250 diesel truck
5 and a 1987 Chevrolet Celebrity. FMCC has a security interest in
6 both vehicles. The parties focused much of their evidence and
7 argument on how to value the vehicles in light of the recent
8 decision by the Ninth Circuit Court of Appeals in In re Taffi, 96
9 F.3d 1190 (9th Cir. 1996) (*en banc*), cert. denied 1997 WL 339171
10 (June 23, 1997). Taffi overruled In re Mitchell, 954 F.2d 557 (9th
11 Cir.), cert. denied 506 U.S. 908 (1992), which had held that,
12 generally, vehicles are to be valued at the price the creditor was
13 likely to receive upon disposition of its collateral. In Taffi, the
14 court held that, in cases in which the debtor is going to retain the
15 collateral,

16 "value has to be the fair market value . . . [of the
17 collateral].

18 "The fair market value is not 'replacement value'
19 because the [collateral] is not being replaced. The fair
20 market value is the price which a willing seller under no
compulsion to sell and a willing buyer under no compulsion to
buy would agree upon after the property has been exposed to
the market for a reasonable time."

21 96 F.3d at 1192.

22 In practice, under Mitchell, wholesale value had become the
23 prevalent valuation standard for cars. FMCC argues that, by
24 implication, Taffi's reversal of Mitchell must mean that retail
25 valuation should now be the standard. The term "retail" is
26 generally understood to mean the prices paid by buyers who purchase

1 vehicles from automobile dealers. Taffi did not explicitly answer
2 the question of what markets should be considered in determining
3 fair market value.

4 After I took this matter under advisement, the Supreme Court
5 decided In re Rash, No. 96-454, 1997 WL 321231 (U.S. June 16, 1997).
6 The Court agreed with Taffi and provided further guidance on the
7 meaning of fair market value, holding that fair market value is the
8 price

9 "a willing buyer *in the debtor's trade, business, or*
10 *situation* would pay a willing seller to obtain property of
11 like age and condition." 1997 WL 321231 at *3, n.3 (emphasis
added).

12 The Court also noted, however,

13 "that replacement value, in this context, should not include
14 certain items. For example, where the proper measure of the
15 replacement value of a vehicle is its retail value, an
16 adjustment to that value may be necessary: A creditor should
17 not receive portions of the retail price, if any, that
reflect the value of items the debtor does not receive when
he retains his vehicle, items such as warranties, inventory
storage, and reconditioning." Id. at *7 n 7.

18 In view of the Rash decision, I conclude that, in this case,
19 valuation should be based on prices paid in the market that is
20 accessible to the debtors, which includes, without limitation, sales
21 by dealers to the public, auctions open to the public, and sales
22 between private parties.¹ That market is broader than the "retail"
23 market. One must then deduct from the prices realized at such sales

24
25 ¹ There is no evidence that the debtors' trade, business or situation is
26 such that they have access to the wholesale market. If they did, under Rash, the
valuation analysis would focus on values in the wholesale market.

1 the value added by reconditioning, warranties, and the cost of other
2 services or additions provided by the seller. Rash, 1997 WL 321231
3 at *7.

4 The term "fair market value" reflects the cash price that a
5 willing buyer would pay a willing seller in an arms-length
6 transaction, free of any compulsion or duress. The evidence
7 indicates that an automobile dealer's selling price may be higher
8 than it would be for a simple cash sale of the vehicle² if the
9 dealer gives the buyer a trade-in allowance that is higher than the
10 trade-in vehicle's actual value or if the dealer is required to make
11 financing concessions or pay a third party to provide concessions.
12 The evidence also indicates that the seller dealer may be willing to
13 sell the vehicle at a lower price than it would charge for a simple
14 cash sale of the vehicle if the buyer purchases mechanical and/or
15 credit life/disability insurance or agrees to financing terms and
16 has credit-worthiness such that the dealer is able to make a profit
17 from the financing. For instance, the testimony in this case was
18 that, generally, used vehicles are sold "as is" and the debtor is
19 given the opportunity to purchase a mechanical warranty. Such
20 warranties cost the dealer \$300 - \$500, and the dealer sells the
21 warranty for \$800 - \$1,200, thus making a \$500 - \$700 profit. In
22 essence, to determine the true cash amount of a dealer's sale, one
23 would have to adjust the price to eliminate the effect of these

24
25 ² A simple cash sale of the vehicle means a sale for cash (no financing
26 provided or required as part of the transaction), without a trade-in, and without
the buyer purchasing any additional products, such as disability, life or
mechanical insurance, in conjunction with the sale.

1 extra profit and cost items. This is similar to the recognized
2 process in real property valuations in which adjustments are made to
3 the price of comparable sales if the seller provided financing
4 concessions.

5 The valuation evidence submitted in this case consisted of
6 the following. Anthony Brady, who has eighteen years of experience
7 in the car industry, eleven of which involved working as an
8 automobile appraiser, testified that he valued the truck at \$8,603
9 and the Celebrity at \$2,315. Robert Wilson, a used car dealer who
10 has many years experience in the automobile retail industry,
11 including being involved in the sales of several thousand used cars
12 and trucks, testified that, in his opinion, the fair market value of
13 the truck is \$5,600 in its current condition and the fair market
14 value of the Celebrity is \$1,200. On cross-examination, he
15 testified that he had these additional opinions with respect to the
16 truck: (1) a dealer could sell the truck for \$6,200 if the dealer
17 reconditioned and otherwise prepared the truck for a retail sale;
18 and (2) the actual cash value that a wholesaler or dealer would pay
19 for the truck is \$4,500. The Kelley Auto Market Report Blue Book
20 (Jan. - Apr. 1997, Western ed.) ("Blue Book") values the truck at
21 \$6,250 wholesale and \$9,740 retail³ and the Celebrity at \$2,700

22
23 ³ The Blue Book explains its use of the terms "wholesale" and "retail"
as follows:

24 "WHOLESALE VALUES are based on clean vehicles fully reconditioned and ready
25 for resale with acceptable mileage as indicated by the zeros on the mileage
charts.

26 (continued...)

1 wholesale and \$4,760 retail. Mr. McElroy testified to values
2 identical to those expressed by Mr. Wilson, although he said that he
3 reached his conclusion based upon his review of advertisements for
4 like vehicles and was unaware of Mr. Wilson's opinion. He further
5 testified that in July 1996, he sought offers from dealers for the
6 truck and was offered \$5,000.

7 I find Mr. Wilson's testimony more persuasive than Mr.
8 Brady's.⁴ The biggest problem with Mr. Brady's valuation technique
9 is that it relies primarily on advertised asking prices, not actual
10 sales prices.⁵ He does not determine the actual sales price of the

11 ³(...continued)

12 "SUGGESTED RETAIL VALUES represent Kelley Blue Book's estimated dealer
13 asking price. The actual selling price may vary substantially."

14 Exhibit A. According to Mr. Brady, the Blue Book defines wholesale as the amount
15 a dealer can expect to pay for a particular type of vehicle and assumes that it is
in the condition described above.

16 ⁴ I am not prepared to totally reject Mr. Brady's testimony for two
17 reasons. First, he did actual research regarding vehicles of the type at issue.
18 Second, according to Mr. Brady's testimony, his method is accepted by the
insurance industry in establishing the value of vehicles. Insurance companies
have every incentive not to overvalue vehicles.

19 ⁵ Mr. Brady's unwillingness to seek actual sales prices is
20 understandable. It became clear from the evidence that it would be extremely
21 difficult for an appraiser to determine the actual sales price of vehicles sold by
22 dealers because one would have to adjust the actual sales prices to neutralize the
23 effect of trade-in vehicle agreements, insurance policy sales, and financing
24 concessions or profits. Mr. Brady testified that dealers will not provide such
information because it would reveal business strategies and other confidential
financial information. But determining actual sales prices is exactly what the
court has to do under Taffi and Rash. Mr. Brady did not provide a good
explanation for why he could not obtain information from private parties regarding
actual sales prices and aspects of those sales that would require price
adjustments to determine the cash price indicated by the sale.

25 Debtor's counsel argues that Mr. Brady's reliance on asking prices
26 rather than completed sales is so flawed that the court should give no weight to
the opinions he expressed. Mr. Brady has substantial relevant experience in the
(continued...)

1 advertised units. His rationale for using asking prices, rather
2 than actual sales prices, is that dealers advertise vehicles at a
3 reasonable price because the purpose of the advertisement is to
4 induce potential customers to come to the dealer's business. If the
5 price is too high, prospective customers will not come to look at
6 the vehicle. Mr. Brady did not testify to any empirical evidence or
7 publications to support his theory.⁶ The Blue Book suggests the
8 contrary. It states that "the actual selling price may vary
9 substantially" from the dealer asking price. See p.5, n. 2.
10 Mr. Wilson testified that generally dealers price vehicles in order
11 to allow room for bargaining because buyers expect to bargain. With
12 respect to advertisements placed by private parties, Mr. Brady
13 testified that sellers sometimes start high, but they lower their
14 prices within two to three months. Although Mr. Brady used
15 advertisements over a few month period, his method will not
16 necessarily capture the final asking price of the buyer because the
17 seller may not run advertisements for the entire period and, even if
18 the seller did that, the seller's final advertisement may not be in

22 ⁵(...continued)
23 automobile industry. His reliance on asking prices, which would not normally be
24 admissible to establish value, see United States v. Smith, 355 F.2d 807 (5th Cir.
1966) (condemnation case), does not prevent him from expressing an admissible
opinion. F.R.E. 703.

25 ⁶ Mr. Brady's approach would be more credible if he had compared actual
26 sales prices to advertised prices for a number of varied vehicles and found a
small or non-existent gap.

1 the period of the advertisements reviewed by Mr. Brady.⁷

2 In addition to the flaw in Mr. Brady's methodology, he did
3 not obtain enough information about some of the vehicles he used as
4 comparables to determine if they were truly comparable. He did not
5 obtain the mileage of many of the vehicles even though he testified
6 that mileage affects value.

7 Mr. Wilson drove the vehicles as part of his investigation of
8 their mechanical condition. Mr. Wilson has experience as a mechanic
9 and he had his ASC certified mechanic with him for the test drive.
10 Mr. Brady did not drive the vehicles; he relied solely on the
11 debtors' response to his inquiry about whether the vehicles had any
12 problems. Mr. Wilson discovered mechanical problems during his test
13 drive of the truck, which he factored into his valuation; Mr. Brady
14 did not consider those problems. Often a person with vehicle
15 expertise may notice mechanical problems by driving a vehicle that
16 the owner, who lacks such expertise, has not noticed or does not
17 recognize as significant. Mr. Wilson testified that the truck has a
18 weak transmission, it pulls to the right when the brakes are
19 applied, the brakes are marginal, and the air conditioning and
20 cassette player do not work. He deducted \$1,750 from his valuation

21
22 ⁷ Mr. Brady's valuation of the 1987 Celebrity demonstrates the potential
23 impact of using asking prices that may not even reflect the last asking price. He
24 had five Celebrity automobiles listed on his appraisal. (Exhibit 6) He chose to
25 disregard the two with the lowest value and average the three with the highest
26 value. The Celebrity with the highest value, \$2,800, had not yet been sold and
had an asking price that was \$1,100 higher than the second highest asking price.
If the unsold Celebrity with the \$2,800 price is excluded and the asking prices
for the other four vehicles are averaged, the value with adjustments would be
\$1,664, rather than the \$2,315 value expressed by Mr. Brady.

1 for the cost of a rebuilt transmission; a new transmission for the
2 truck will cost \$2,800 - \$2,900. He also testified that the lowest
3 cost to repair the air conditioner will be \$200 because of the
4 current Freon recovery requirements.

5 Based upon the evidence, I conclude that the value of the
6 truck is \$5,950 and the value of the car is \$1,570. I determined
7 the value of the truck by deducting \$1,950 for the cost of the
8 transmission and air conditioner repairs from Mr. Brady's value,
9 which did not take those into account. I then gave Mr. Wilson's
10 opinion twice as much weight as Mr. Brady's opinion and rounded off
11 the number. With respect to the car, no adjustments were made, but
12 I gave Mr. Wilson's opinion twice as much weight as Mr. Brady's
13 opinion and rounded off the number. I gave no weight to
14 Mr. McElroy's opinion. I do not find credible Mr. McElroy's
15 testimony that he coincidentally came up with the same values as his
16 expert, Mr. Wilson. Further, his testimony was based totally on
17 hearsay, he is not an expert who may rely on such hearsay, and
18 offering prices are generally inadmissible to establish market
19 value. See United States v. Smith, 355 F.2d 807, 811 (5th Cir.
20 1966). I did not give any weight to the price a dealer had offered
21 to purchase the truck from debtors, because that is a wholesale
22 price and, under Rash, should not be used in valuing a vehicle these
23 debtors are going to retain.

24 II. GOOD FAITH

25 FMCC argues that debtors have not proposed their plan in good
26 faith as required by 11 U.S.C. § 1325(a)(3), because this is

1 debtors' second Chapter 13 within a short period and debtors have
2 not demonstrated a sufficient change in circumstances. Successive
3 filings can be evidence of lack of good faith absent a bona fide
4 change in circumstances. In re Metz, 820 F.2d 1495 (9th Cir. 1987).

5 Debtors argue that their circumstances did change between
6 their first case and this case. The court dismissed debtors' first
7 case because they missed a plan payment. They missed the plan
8 payment because they had to pay \$268 in unanticipated utility
9 deposits that had not been included in their budget in their first
10 case. In addition, their gross income has increased \$133.

11 Although this is a close case, the facts that debtors are
12 living on a very tight budget, that the utility deposits were
13 unanticipated, and that debtors have had an increase in income,
14 coupled with the absence of any manipulation of the bankruptcy
15 process, the absence of any gain by debtors as a result of the
16 successive filings, and the absence of any of the other factors
17 traditionally associated with lack of good faith⁸ convinces the
18 undersigned that, under the totality of the circumstances, debtors
19 have proposed their plan in good faith.

20 III. FEASIBILITY

21 In view of the increase in the value of the vehicles, which
22 will probably result in an increase in the required plan payment, an
23

24 ⁸ There are some inconsistencies in the budgets debtors filed in the two
25 Chapter 13 cases. Having listened to Mr. McElroy's testimony regarding the cause
26 of the variation, I believe that the numbers were good faith estimates and the
minor variations were not the result of an attempt to mislead the court and
interested parties.

1 adjourned confirmation hearing will be scheduled to determine
2 whether the plan is feasible. At the hearing the court will use the
3 income and expense budgets contained in debtors' Schedule I and J to
4 determine feasibility with the following modifications.

5 First, with respect to income, Mr. McElroy will be required
6 to produce his pay stubs from the last three months (or his last pay
7 stub if it includes year-to-date figures) plus copies of his 1996
8 federal and state income tax returns, so that the proper amount of
9 his income and his payroll deductions for taxes and social security
10 can be determined. Mr. McElroy testified that he is working more
11 overtime than is reflected on his Schedule I.

12 Second, even though debtors' Schedule I income increased \$133
13 between the two filings, debtors' payroll deductions increased \$243.
14 Debtors must explain this increase in deductions. It does not make
15 sense that their deductions would increase more than their increase
16 in income, particularly given that debtors received a significant
17 tax refund for 1996.

18 Third, given Mr. McElroy's testimony regarding the family
19 food budget, coupled with the letter from his counsel received by
20 the court on June 11, 1997, expenses will be calculated based on a
21 food budget of \$450.

22 CONCLUSION

23 Debtors' 1987 Ford F-250 diesel truck is valued at \$5,950 and
24 their 1987 Chevrolet Celebrity is valued at \$1,570. Debtors
25 proposed their plan in good faith. An adjourned confirmation
26 hearing will be scheduled to determine whether the plan is feasible

1 in view of the valuation of the vehicles, an accurate income figure
2 and the increase in debtors' food budget.

3 This Memorandum Opinion shall constitute Findings of Fact and
4 Conclusions of Law as required by Fed. R. Bankr. P. 7052 and they
5 shall not be separately stated.

6
7
8 ELIZABETH L. PERRIS
Bankruptcy Judge

9
10 cc: Magar E. Magar
11 Thomas K. Hooper
Robert W. Myers